

*Kern County*  
**Superintendent  
of Schools**

# Demystifying School Debt Finance

*presented by*

*Kern County Office of Education*

*and*

**California Debt and Investment  
Advisory Commission**



# Mr. John Decker

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§ Executive Director, California Debt and Investment Advisory Commission

# Dr. Dennis Scott, Ed. D.

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- § Associate Superintendent, Kern High School District
- § CASBO: CBO Certification
- § Lecturer in School Finance:
  - t University of La Verne
  - t California State University, Bakersfield

# Mr. Michael Brouse

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- § Assistant Superintendent of Business Services,  
Panama Buena Vista Unified School District
- § Began working with PBVUS in 1996
- § Experience with GO Bonds, COPs and CFDs
- § Lecturer for School Finance
  - † Adjunct Faculty, Fresno Pacific University  
Bakersfield Extension
  - † Adjunct Faculty, Point Loma Nazarene  
University Bakersfield Extension
  - † California State University, Bakersfield

# Ms. Lisalee Wells

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- § Partner, Fulbright and Jaworski L.L.C.
- § 31 years school bond experience
- § Expertise in TRANs, BANs, G.O. Bonds, Certificates of Participation, Mello-Roos CFD Bonds, A.V. Waiver Applications and Election matters
- § Member: National Association of Bond Lawyers
- § Panelist: C.A.S.H., S.S.D.A and C.A.S.B.O. conferences
- § Country music fan

# Mr. John R. Baracy

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- § Vice President, Stone & Youngberg
- § 15 years school district financing experience
- § Expertise in general obligation bonds, certificates of participation/lease revenue bonds, TRANS, bond anticipation notes, build America bonds, tax credit bonds and all other K-12 financing vehicles
- § Member of the ongoing CASH GO Bond Committee, member of CSBA, CASBO and CALSA

# Mr. Adam Bauer, CIPFA

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- § Principal, Fieldman, Rolapp & Associates
- § Manager of School District of Fieldman, Rolapp & Associates
- § Expertise in general obligation bonds, certificates of participation, land secured financings, developer negotiations and school facilities
- § Co-chair of the CASH Fiscal Management Strand, member of CSBA, and CASBO

# Reasons Why School Districts Use Financing

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- § Acquire land
- § Construct/improve buildings
- § Install improvements and facilities
- § Acquire equipment
- § Fund working capital
- § Refinance existing obligations / leases

# Finance Mechanisms & Tools



## § General Obligation Bonds (GO Bonds)

- † Education Code  
(Maturities to 25 yrs)
- † Government Code  
(Maturities to 40 yrs)



## § Bond Anticipation Notes (BANs)

## § Certificates of Participation (COPs)

## § Tax and Revenue Anticipation Notes (TRANS)



# GO Bonds

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## § Assessed Valuation Drives Access

- t Voter Approved Authorization ≠ Cash Available Now
- t Higher growth allows earlier issuance
- t Lower growth/decline hinders issuance
- t Tax Rate Caps – Legal vs Political Restriction?



# Assessed Value Trends

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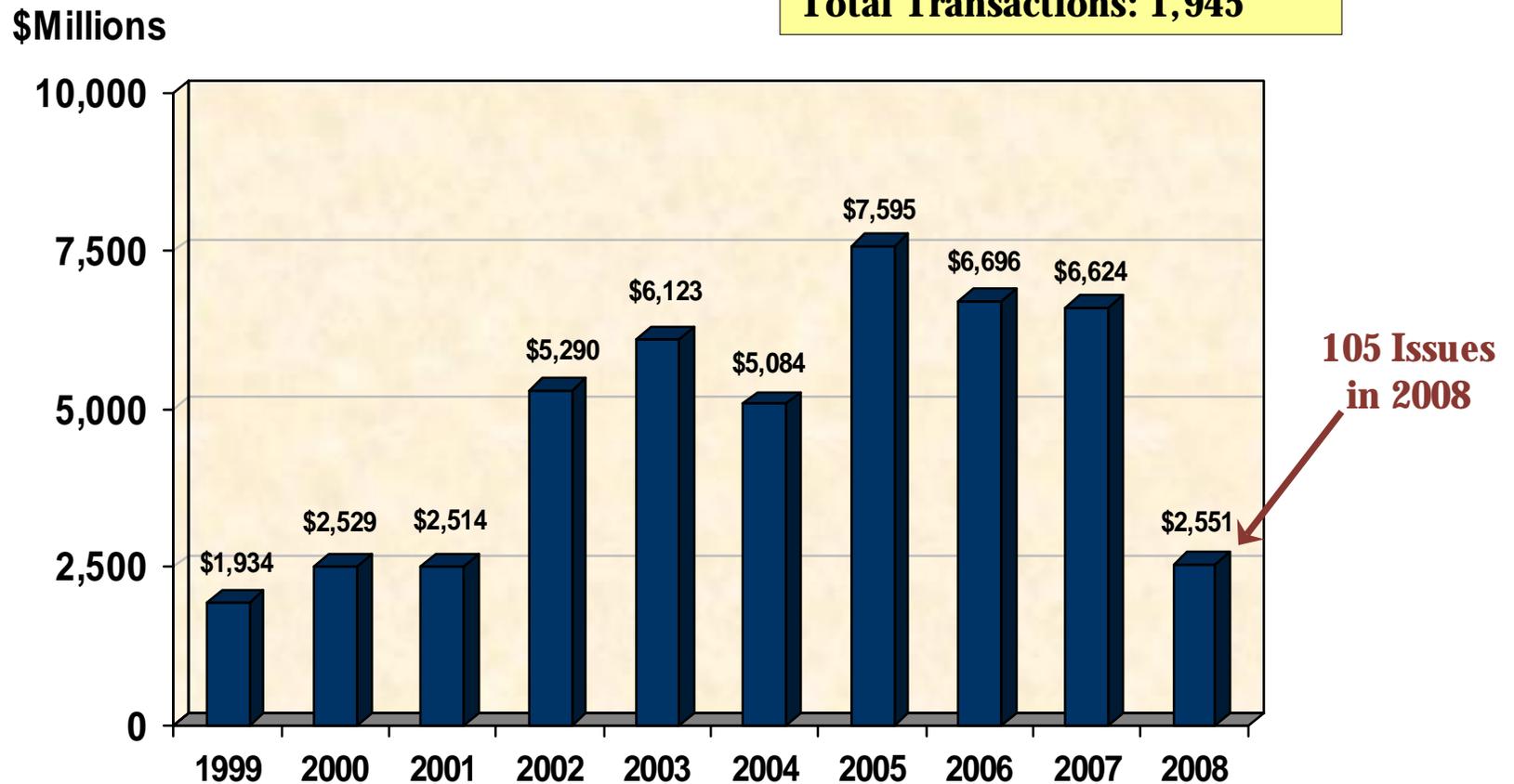
- § The State of California had seen double-digit growth in assessed valuation for many local governments, including school districts, from 2003-2007
- § Recently, this trend has slowed or reduced to high single digit and double digit reductions in assessed valuations in 2008 and 2009
- § What does this mean for K-12 school districts?
  - Lower assessed valuations mean lower 1.25% or 2.50% statutory bonding capacity
  - Limited or no access to proposition approved Proposition 39 \$30 or \$60 per \$100,000 tax rate limitations GO Bond elections due to assessed valuation reductions
  - Political implications due to lack of access to funds may lead to other more expensive financing options for K-12 school districts

# Annual K-12 GO Bond Volume



**1999 - 2008**

**Total Amount: \$54.65 Billion**  
**Total Transactions: 1,945**



Source: California Debt and Investment Advisory Commission (CDIAC)

# BANs

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- § Bond Anticipation Notes can be used to give districts access to cash sooner than bonds
- § Notes and renewals thereof must be payable not more than five years from the date of the original issuance of the first Notes
- § Total amount of Notes or renewals thereof issued and outstanding may not exceed the total amount of unsold (authorized) bonds
- § The proceeds from the sale of the Notes must be used only for authorized purposes of the bonds or to repay outstanding notes previously issued



## § Issue Certificates of Participation

- t Advance/finance bond authorization to undertake immediate facility needs
- t Pay-off w/GO Bonds in future when assessed value has grown
- t Drawback: COPs pay interest that is a current drain on General Fund

# Annual K-12 COPs Volume



## 1999-2008

Total Amount: \$8.84 Billion  
Total Transactions: 701

\$Millions



40 Issues  
in 2008

Source: California Debt and Investment Advisory Commission (CDIAC)

# TRANS



## § Short term borrowing

- t Maximum 13 months
- t May be tax-exempt or taxable
- t Must be repaid from revenues of the same fiscal year; repayment set-asides made during or after the fiscal year

## § Provide working capital and ease cash flow fluctuations during the year

- t Sized to cover maximum cash flow deficit
- t May be used for current expenses, capital expenditures and investment and reimbursement
- t May be able to keep arbitrage earnings

# TRANS

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- § No voter approval required
- § Require school board and county board approval, ratings (or credit enhancements) and disclosure
- § Alternative: Borrow from the County Office or County Treasurer in negative months

# Build America Bonds (BABs)

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- § Taxable bonds with a 35% interest subsidy
  - t Expands market to investors who prefer taxable returns
  - t Bonds that could otherwise be issued as tax-exempt
  - t Government purpose bonds only
    - No Private Activity Bonds, e.g. affordable housing, student loans, IDBs, 501(c)3 bonds
  - t No volume limitation for bonds issued in 2009 and 2010
  - t Program expires December 31, 2010
  - t District choice: Direct Payment BAB or Tax Credit BAB

# Direct Payment BABs

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- § District receives subsidy of 35% of interest payment
  - federally guaranteed revenue stream
  - † Payments can go directly to bond trustee or
  - † Payments may go directly to district for other expenditures
  
- § Limit of 2% for costs of issuance
  
- § No refundings permitted
  
- § Arbitrage calculations based upon net payment by district

# Tax Credit BABs

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- § Bondholder receives 35% tax credit
  - † Tax credit payment is taxable
  - † Paid quarterly
- § May strip the tax credits and sell them separately
- § Same rules for capitalized interest & issuance costs as apply to tax-exempt bonds
- § Tax credits do not count in arbitrage calculations
- § Refundings are permitted
- § May be helpful to soften Prop 39 tax levy by removing the interest component

# California K12 School District ARRA Issues



## Build America Bonds (BABs)

Issuer	Issue Date	Total Issue Size	Taxable Portion
Oakland USD	8/12/2009	\$158.7M	\$70.8M
West Contra Costa USD	9/3/2009	\$162.8M	\$52.8M
Santa Monica - Malibu USD	8/5/2009	\$60.0M	\$48.1M
Napa Valley USD	8/4/2009	\$30.0M	\$21.5M
<b>Total</b>			<b>\$193.2M</b>

## Tax Credit Bonds

Issuer	Issue Date	Total Issue Size	Tax Credit Portion
San Diego USD	5/7/2009	\$38.8M	\$38.8M
Oakland USD	8/12/2009	\$26.3M	\$26.3M
<b>Total</b>			<b>\$65.1M</b>

# Qualified School Construction Bonds (QSCBs)



## What are QSCBs?

- t A new form of tax credit bond to promote the construction and improvement of public schools
  - U.S. Treasury Department initially allocated QSCBs to large urban districts in California
  - State has established regulations for allocating volume cap to other districts
- t Bonds are sold with a tax credit to investors that substantially replaces interest payments on the bonds
- t Fewer restrictions for eligibility compared with other tax credit bonds such as Qualified Zone Academy Bonds (“QZABs”)
- t Debt repayment period of 14-16 years
- t Not free money to school districts, but rather interest free loans
- t Principal amount can be repaid with annual installments or sinking fund deposits over specified years
- t QSCBs may be repaid using almost any revenue source available to a school district

# California QSCB Allocations and Use of Proceeds



## California Allocations

- t In 2009, the State will allocate \$773.5 million to local school districts after August 25, 2009, and \$582.0 million directly to 11 large districts (see chart below)

<u>Local Education Agency</u>	<u>2009 Allocation</u>	<u>Local Education Agency</u>	<u>2009 Allocation</u>
Bakersfield City ESD	\$15,720,000	Oakland USD	\$26,326,000
Compton USD	18,559,000	Sacramento City USD	21,251,000
Fresno USD	41,398,000	San Bernardino City USD	27,790,000
Long Beach USD	37,905,000	San Diego USD	38,877,000
Los Angeles USD	318,816,000	Santa Ana USD	19,269,000
		Stockton City USD	16,055,000

- t In 2010, the State will allocate \$1.36 billion total to school districts which will be available for allocation beginning January 1, 2010

## Use of Proceeds

- t Public school construction, rehabilitation and repair
- t Acquisition of land for facility funded with QSCBs
- t Equipment for use in facility funded with QSCBs (or portion thereof)

# How Interest Rates are Determined for QSCBs



The tax credit rate for the life of the QSCB bond is set by the U.S. Treasury daily (7.07% on 7/6/2009) and can be found at the following website:

[https://www.treasurydirect.gov/govt/rates/irs/rates\\_qtcb.htm](https://www.treasurydirect.gov/govt/rates/irs/rates_qtcb.htm)

**Qualified Tax Credit Bond Rates**

Section 54A of the Internal Revenue Code (IRC) provides rules for the issuance and use of qualified tax credit bonds including new clean renewable energy bonds, qualified energy conservation bonds, qualified zone academy bonds, and qualified school construction bonds. For rates on clean renewable energy bonds issued under Section 54 of the IRC, check our [CREB page](#).

Date	Rate	Maturity	PSFY*
July 06, 2009	7.07%	15 yrs	4.71%

**SEARCH HISTORICAL QTCB RATES**

From Date			To Date		
Month	Day	Year	Month	Day	Year
<input type="text"/>					

\*Permitted Sinking Fund Yield - The maximum permitted yield for the sinking fund expected to be used to repay the issue under section 54A(d)(4)(C) of the IRC. The permitted sinking fund yield is equal to 110% of the long-term adjusted applicable federal rate (AFR), compounded semiannually. The permitted sinking fund yield is updated monthly.

**These rates will normally be published by 10:00 am ET each federal business day.**

For more information on qualified tax credit bonds, call the Internal Revenue Service's Office of Associate Chief Counsel (Financial Institutions & Products) at (202) 622-3980.

# Lessons Learned: SDUSD QSCB

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- § SDUSD did first QSCB in the nation - \$38.7 million of GO Bonds
- § Special Challenges:
  - t Redemptions required
  - t “Make Whole” penalty
  - t 2% limit on COI
- § Tax Credit “Strips”
- § Taxable bonds still subject to arbitrage rebate and audit

# Identifying the Need

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- § Student enrollment growth
  - † Updated enrollment projections
  - † Available facilities
  - † Demonstrated facility needs (Project)
    - New Facilities
    - Modernization

# Building the Support



- § Voter research poll
  - t Voter profile
  - t Project and Measure Support
- § Campaign Advice
  - t Campaign Consultant
  - t Campaign steering committee
- § District Activities to build support of the Measure
  - t Financial Activities in order (Clean House)
  - t Clear and Consistent Message
  - t Supportive community leaders
  - t Supportive school district staff
  - t Engage the taxpayer early in the process
- § Campaign
  - t Funding
  - t Media Promotions
  - t Phone Bank
  - t Speakers Bureau
  - t Endorsement

# Financing Team Members and Roles



## Role of the Professionals:

- § Issuer Internal Team:
  - Superintendent
  - Chief Business Official
  - Facilities Director
  - District Counsel
  
- § Issuer Consultants:
  - Bond Counsel
  - Disclosure Counsel
  - Dissemination Agent
  - Campaign Consultant
  - Financial Advisor
  - Trustee
  - Underwriter
  
- § Third Parties:
  - County Treasurer/Auditor
  - Rating Agency
  - Credit Enhancer

# Financing Team Members and Roles *(cont'd)*



## Their Collective Role:

- § Optimal structuring to accomplish goals
- § Minimize potential for legal liability
- § Better market acceptance of debt being sold

# Financing Team Members and Roles *(cont'd)*

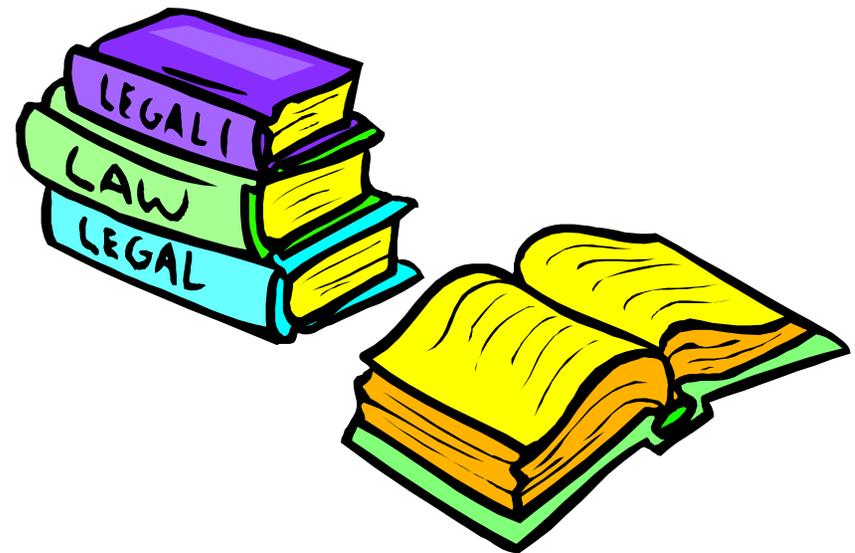


## Bond Counsel:

- § Provides legal parameters and guidelines to School District and Financing Team
- § Drafts legal documents pursuant to which debt is issued/secured
- § Provides the legal opinion stating that debt is *exempt* from federal and state income taxes (California)

or

That QSCBs and BABs are valid obligations and exempt from California income taxes *only*



# Financing Team Members and Roles *(cont'd)*



## Financial Advisor:

- § Advises and assists in the formulation/execution of financing plans
- § Does not purchase or underwrite debt
- § Role of financial advisor depends on:
  1. the needs of the School District
  2. the method of sale chosen and/or
  3. the complexity of the financing



# Financing Team Members and Roles *(cont'd)*



## Underwriter:

- § Purchases debt with the intent to resell to investors
- § In a negotiated sale the underwriter is hired early in the process and assists the School District and other members of the financing team
- § In a competitive sale, the Underwriter simply delivers a sealed bid on the date of sale offering to purchase the debt at fixed interest rates and prices

## Campaign Consultant:

- § Hired by the district to conduct marketing campaign for election
- § Works directly with district staff, legal and financial team to determine most successful strategy to win bond election

# Financing Team Members and Roles *(cont'd)*



## Disclosure Counsel:

- § A law firm retained to assist the District in fairly disclosing all pertinent facts relating to the debt offering

## Bond Trustee / Registrar / Paying Agent:

- § Usually a bank with trust power which acts in a fiduciary capacity for the benefit of the bondholders in enforcing the terms of the bond documents
- § Maintains records on behalf of the issuer for the purpose of notifying the owners of registered bonds
- § Pays interest and principal on bonds on behalf of the issuer

# Financing Team Members and Roles *(cont'd)*

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## Dissemination Agent:

- § The Dissemination Agent takes responsibility for filing the Annual Report under the Continuing Disclosure Agreement and filing notices of material events

## County Treasurer / Auditor:

- § The principal duties include the management and investment of County, School and Special District funds
- § Bond Administration (general obligation bonds)
- § Collection of taxes and revenues

# Financing Team Members and Roles *(cont'd)*



## Underwriter's Counsel:

- § A law firm retained by the Underwriter to represent the Underwriter's interests

## Rating Agency:

- § An independent service that provides a credit quality evaluation of bonds and notes. Standard & Poor's, Moody's and Fitch are common for school district credit ratings

## Credit Provider:

- § An institution that lends its credit for a cost to provide a school district the opportunity for a lower cost of borrowing (i.e., Bond Insurance, Liquidity Facility or Letter of Credit)

# Upcoming Prop. 39 Election Dates

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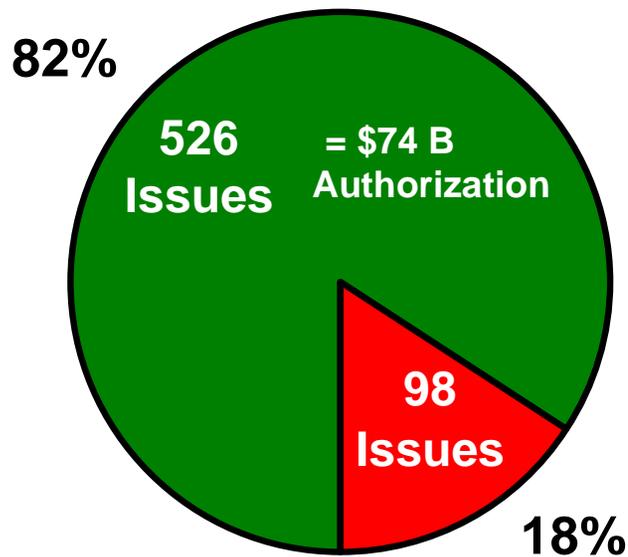
- § June 8, 2010 – Primary Election
  
- § November 2, 2010 – General Election
  
- § Other dates only if coincide with regularly scheduled district-wide election
  - t School Board election
  - t County election
  - t Special District election
  - t Community College election

# Historical Results

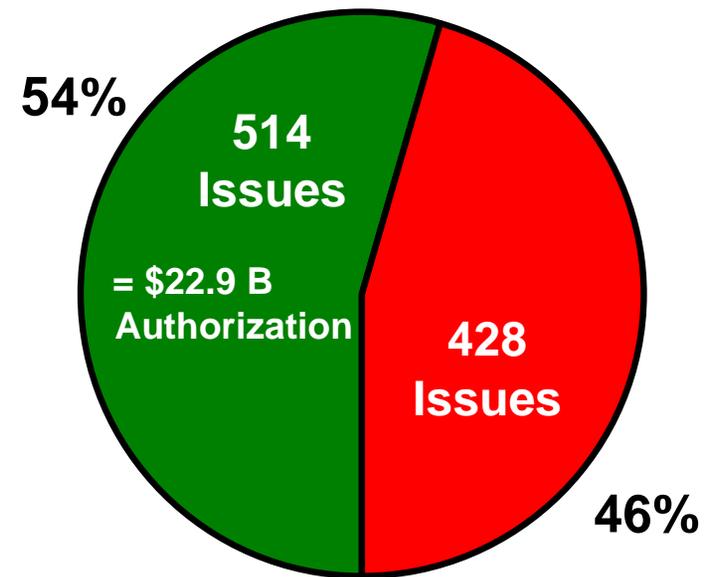


## School District GO Election Results: January 1986 – November 2008

**Prop. 39 (1)**



**Prop. 46**



(1) Proposition 39 elections commenced in Spring 2001.

Source: School Services of California



# Tax Rates

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$$\text{Tax Rate} = \frac{\text{Annual Debt Service}}{\text{Assessed Valuation}}$$

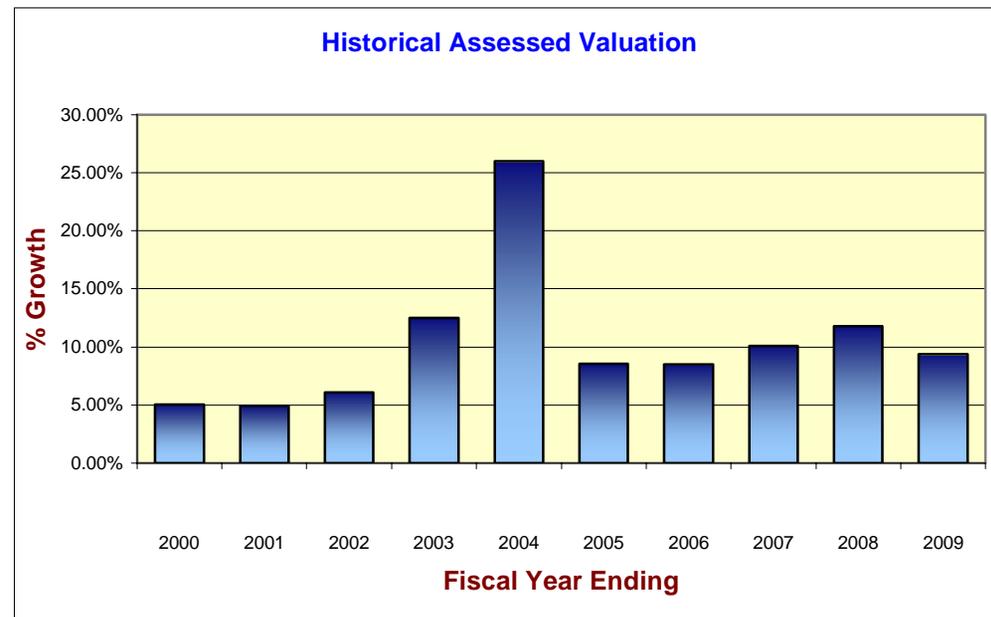
- § Therefore, bonding capacity at a given tax rate is a function of the following variables:
- † Beginning Assessed Valuation of Taxable Property
  - † Assumed Growth Rate of Assessed Valuation
  - † Number of Years Tax to Levied
  - † Assumed Interest Rates on Bonds
  - † Timing and Amount of Individual Bond Sales
  - † Shape of Debt Service Profile

# History of Assessed Valuation



<b>FY Ending</b>	<b>Assessed Valuation</b>	<b>AV Growth</b>
1999	\$687,055,994	-
2000	721,695,404	5.04%
2001	757,220,988	4.92%
2002	803,428,129	6.10%
2003	903,745,727	12.49%
2004	1,138,476,772	25.97%
2005	1,235,918,619	8.56%
2006	1,340,791,145	8.49%
2007	1,476,442,534	10.12%
2008	1,650,373,253	11.78%
2009	1,804,850,737	9.36%

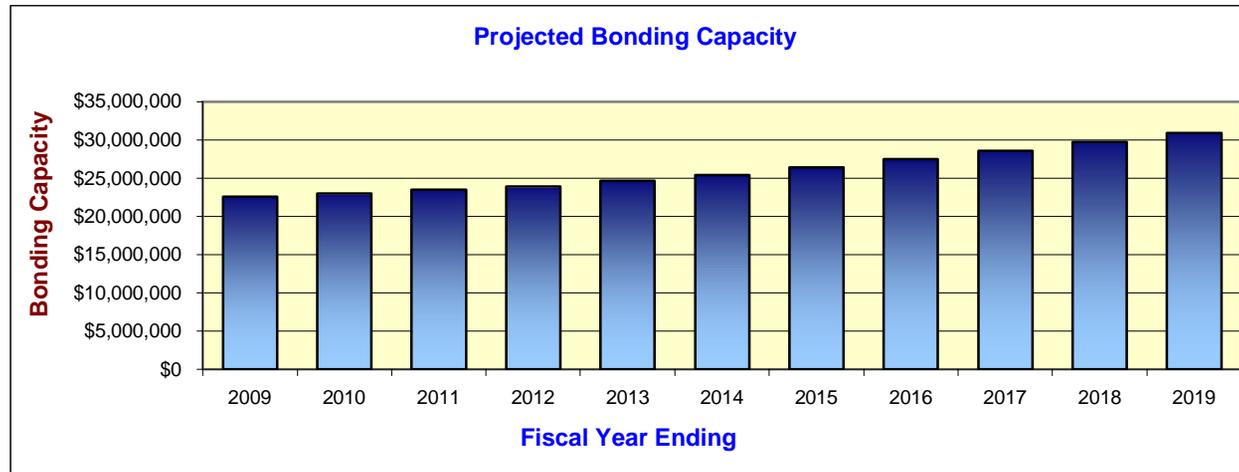
**Average Growth Rate: 10.28%**



# Statutory Bonding Capacity (Waiver)

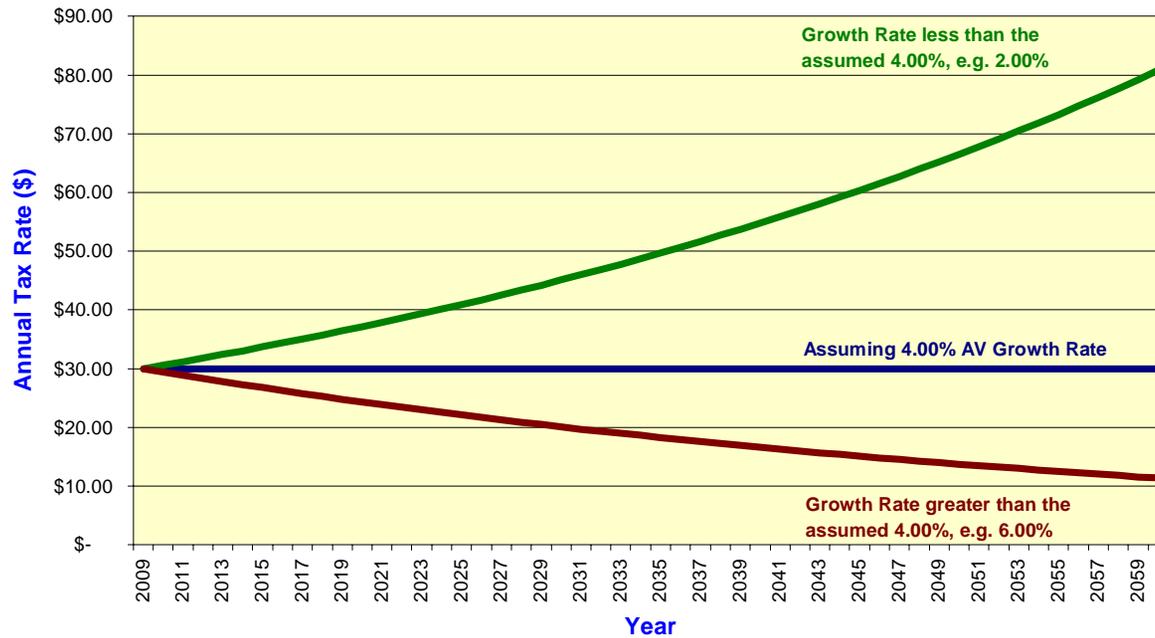


<b>FY Ending</b>	<b>Assessed Valuation<sup>(1)</sup></b>	<b>Assumed % of AV Growth<sup>(2)</sup></b>	<b>Bonding Capacity</b>
2009	\$1,804,850,737	-	\$22,560,634
2010	1,840,947,752	2.00%	23,011,847
2011	1,877,766,707	2.00%	23,472,084
2012	1,915,322,041	2.00%	23,941,526
2013	1,972,781,702	3.00%	24,659,771
2014	2,031,965,153	3.00%	25,399,564
2015	2,113,243,759	4.00%	26,415,547
2016	2,197,773,510	4.00%	27,472,169
2017	2,285,684,450	4.00%	28,571,056
2018	2,377,111,828	4.00%	29,713,898
2019	2,472,196,301	4.00%	30,902,454



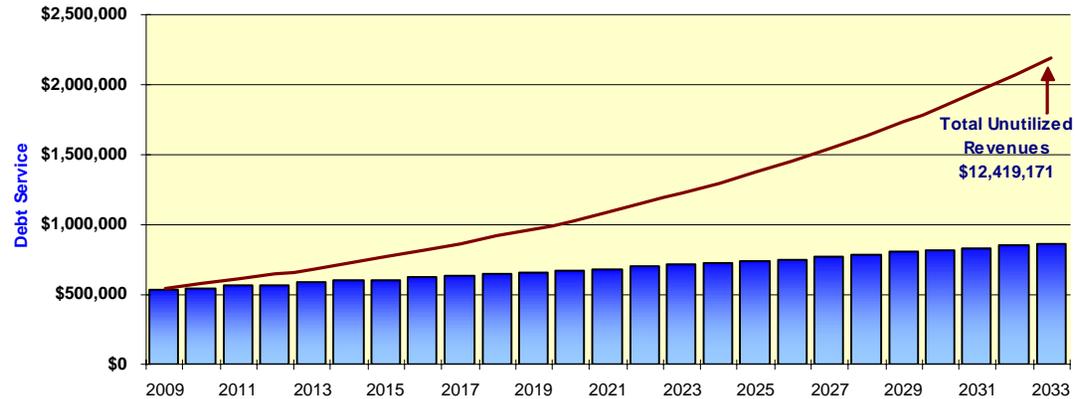
- (1) Estimates based on Historical Assessed Value Growth.
- (2) Estimates must be reviewed and discussed with School District.

# Impact of AV Growth Rate on Tax Rates



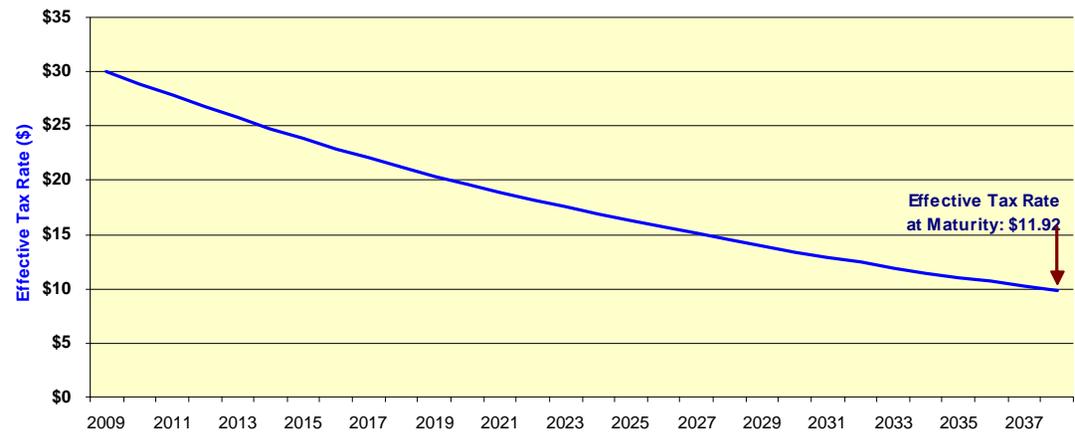
	Year 1	Year 5	Year 10	Year 25	Year 50
<b>Tax Rate if AV Grows at Assumed Rate (e.g., 4.00%)</b>	\$ 30.00	\$ 30.00	\$ 30.00	\$ 30.00	\$ 30.00
<b>Tax Rate if AV Grows at Slower Than Assumed Rate (e.g., 2.00%)</b>	\$ 33.71	\$ 37.14	\$ 37.14	\$ 49.70	\$ 80.76
<b>Tax Rate if AV Grows at Faster Than Assumed Rate (e.g., 6.00%)</b>	\$ 26.76	\$ 24.33	\$ 24.33	\$ 18.28	\$ 11.36

# Conservative Planning



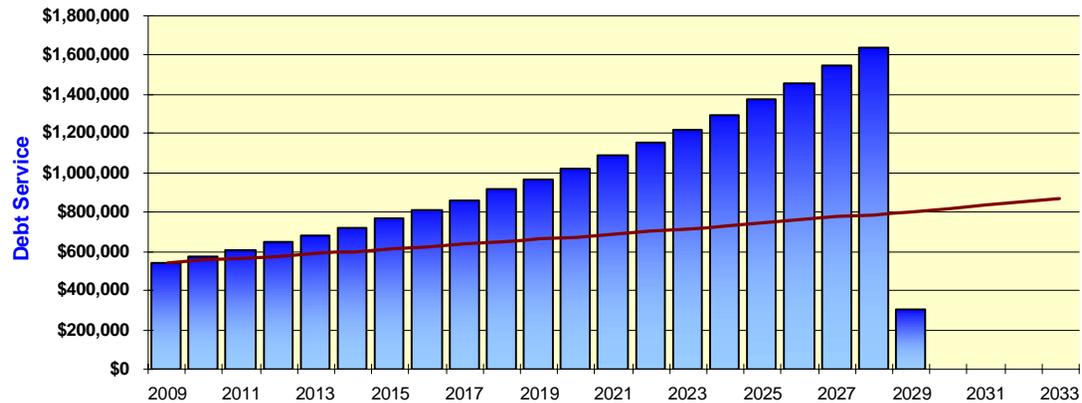
■ Debt Service Assuming 25-Year \$9.075 million Bond Issuance and 2.00% AV Growth Rate\*  
— Available Revenue at \$30 Tax Rate with 6.00% AV Growth Rate

\* Debt Service uses 12/4/2008 Index 94 Delphis Hanover Corporation interest rates. Interest rates are subject to change based on market conditions.



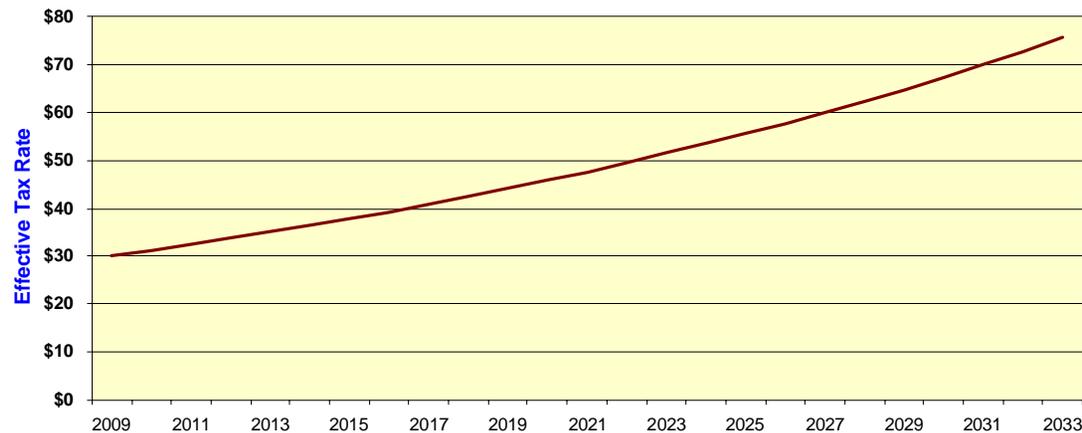
— Annual Tax Rate with 6.00% Actual AV Growth Rate

# Aggressive Planning



■ Debt Service Assuming 25-Year \$11.345 million Bond Issuance and 6.00% AV Growth Rate\*  
— Available Revenue at \$30 Tax Rate with 2.00% AV Growth Rate

\* Debt Service uses 12/4/2008 Index 94 Delphis Hanover Corporation interest rates. Interest rates are subject to change based on market conditions.



— Annual Tax Rate with 2.00% Actual AV Growth Rate

# Two Types of Bond Sales



## § Competitive Sale

- † Underwriter is selected on day of pricing by submitting lowest bid for the bonds
- † Underwriter does not participate in financing
- † Rates of borrowing based on bids submitted on day of pricing

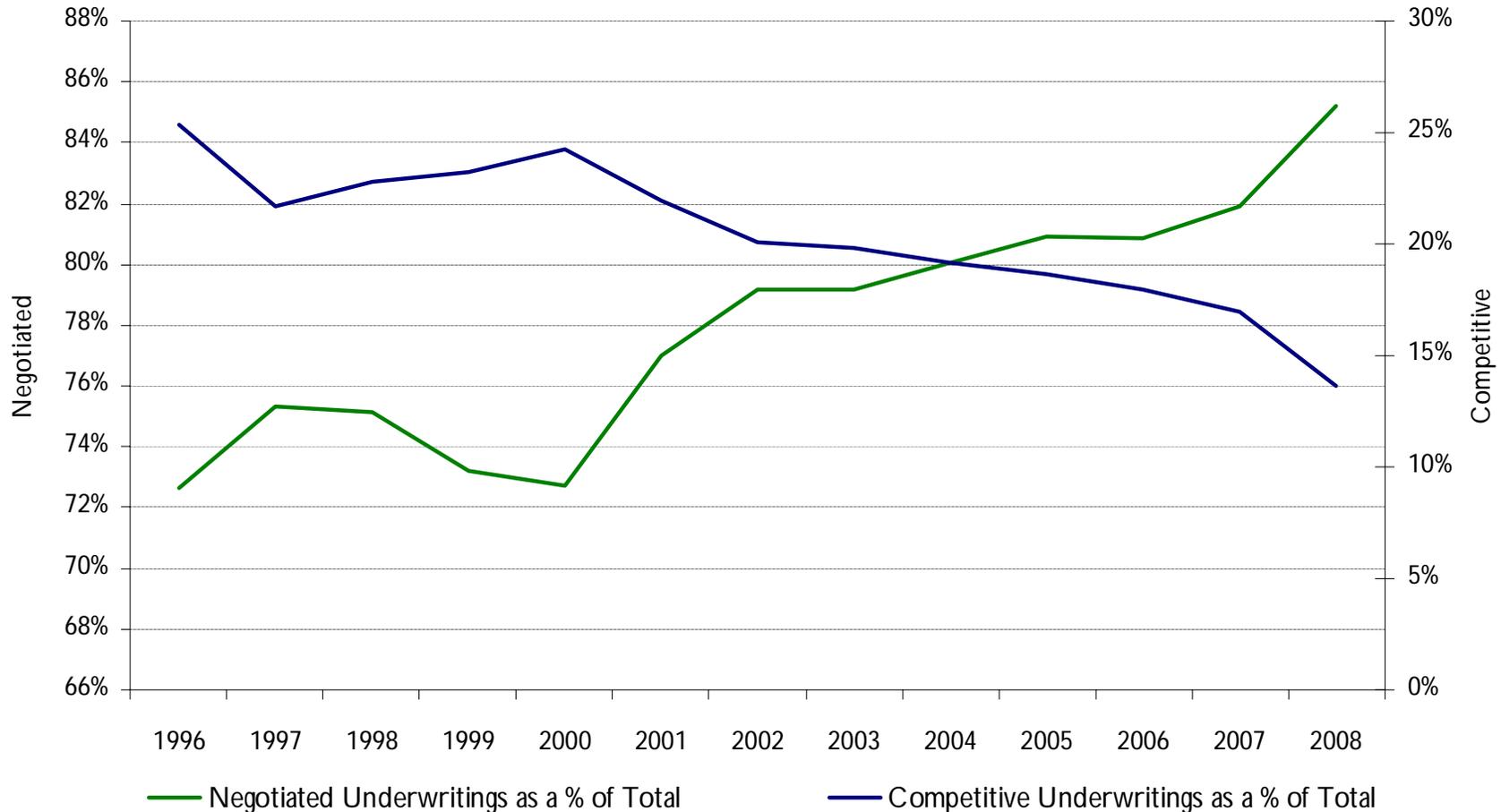
## § Negotiated Sale

- † Underwriter selected prior to sale date
- † Underwriter participates in structuring
- † Rates of borrowing based on collaboration with Financial Advisor and Issuer

# Negotiated vs. Competitive



Negotiated & Competitive Underwritings as a % of Total Issuance (1996 – 2008)



Source: CDIAC and SIFMA. Includes issues with maturity greater than 13 months.

# Arguments for Both Types of Sale

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## § Competitive

- t Sometimes legally required
- t Treats bond transactions as commodities
- t Issuer able to say they got the best rate available that day at that time

## § Negotiated

- t More expertise at the table
- t Allows underwriter to premarket or tell a credit story to potential investors
- t Changes can be made during pricing to react to a changing market

# School District Role

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## § Fiduciary responsibility

- t Analyze needs and estimate their cost and timing
- t Optimize leverage (not too big or too small)
- t Minimize credit cost

## § Selecting team members

- t Plan ahead to allow time for an RFP
- t Develop a scoring rubric to minimize subjectivity
  - Don't underestimate your "gut"

## § Provide data for Offering Statement and review all documents to make sure they

- t Represent the School District's Goals and Objectives
- t Fairly portray the financial position and ability of the District and its taxpayers

# Getting the Best Deal



- § Assume competitive sale will be used
- § Use a negotiated sale only if a better result is indicated
  - † Complex issues
  - † Need for flexibility
  - † Timing constraints
  - † Rates
  - † Be prepared to make your case
- § Secure the best rating possible
- § Test the rates
  - † Do comparables within a few days of your sale
- § Don't commit to any sale that costs more than you can afford

# Administering the Debt

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## § Continuing Disclosure Obligations

- † Provide updated data

## § Be sure payments are timely and correct

- † Trustee

- † Auditor-Controller

# Tax Code Compliance

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- § Most District deals require compliance with the Internal Revenue code – even “taxable” QSCBs and BABs
- § Projects must be for public use
- § Proceeds must/should be spent in 3 years
- § No early issuance
- § No over issuance
- § No deliberate arbitrage (profit) on investment

# Tax Code Compliance – *con't*

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§ Reporting to IRS (8038G)

§ Post- issuance compliance

- t Allocation

- t Record-keeping

- t Arbitrage payment

§ Audits

- t May not result in penalties (“random”)

- t Require assistance of tax lawyer

- t Worst case: “Going Taxable”

# Municipal Market Landscape Redefined in 2008



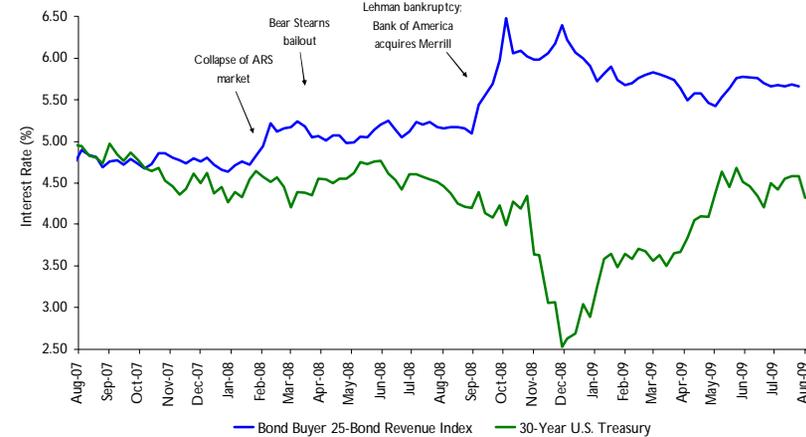
- § Decoupling of Markets
  - t “Flight to Quality” in Treasuries
  - t Away from other sectors
  - t Long-dated munis still trading at historically high percentages of their Treasury counterparts

- § Collapse of Enhancement Market
  - t Demise of most AAA bond insurers
  - t Letter of Credit/Liquidity market upheaval

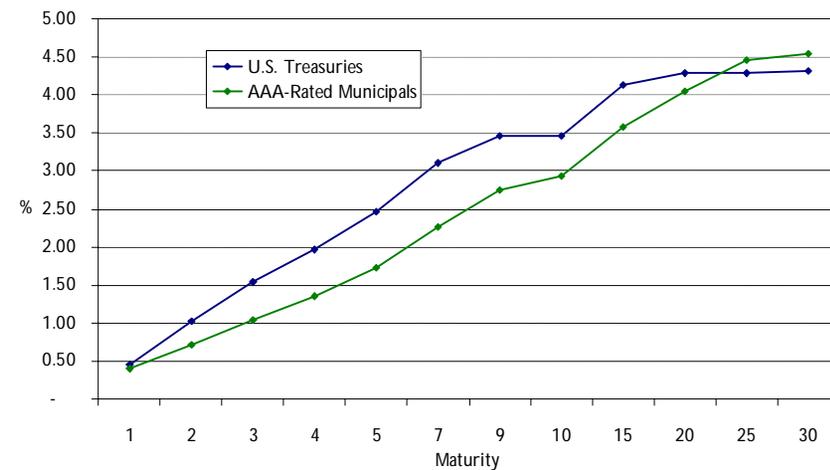
- § Strained Variable Rate Sector
  - t Auction rate market collapse
  - t Limited access to liquidity

- § Retreat of Wall Street Firms
  - t Departure of Bear Stearns, Lehman Brothers, Merrill Lynch, UBS, Wachovia
  - t Constrained capital positions

**Bond Buyer 25-Bond Revenue Index v. 30-Year US Treasury (August 2007 - Present)**



**Treasury vs. AAA-Rated Tax-Exempt Municipal Yield Curves (8/19/2009)**



# Functioning Municipal Market



## § Market Response

- t Steeper yield curve
- t Wider credit spreads

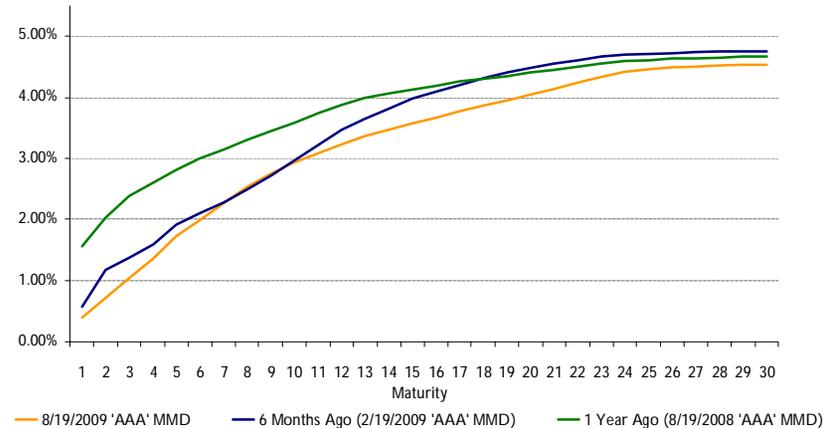
## § Focus on Highest Quality Credits

- t GO or essential service credits
- t AA as the “new AAA”
- t Insurance still has value for some credits

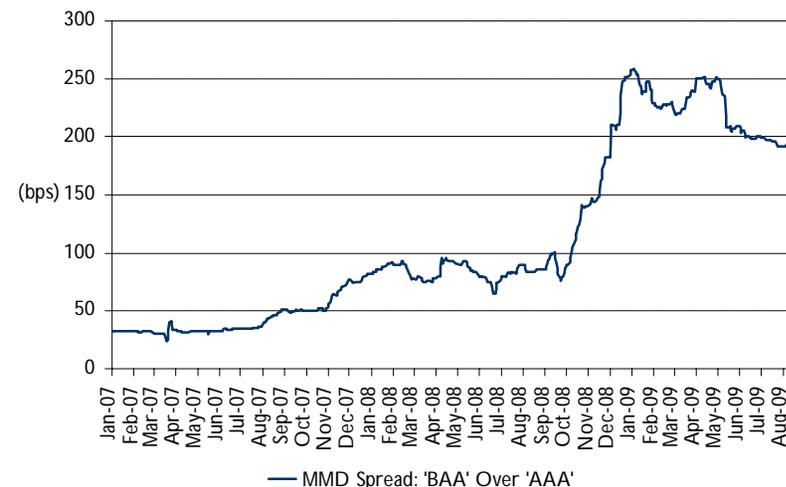
## § Uncertain 2009 Issuance Volume

- t Many borrowings postponed in Q4 2008 and Q1 2009
- t Volume-to-date lighter than expected
- t Continuing variable rate restructurings

Comparative 'AAA' MMD Yield Curves



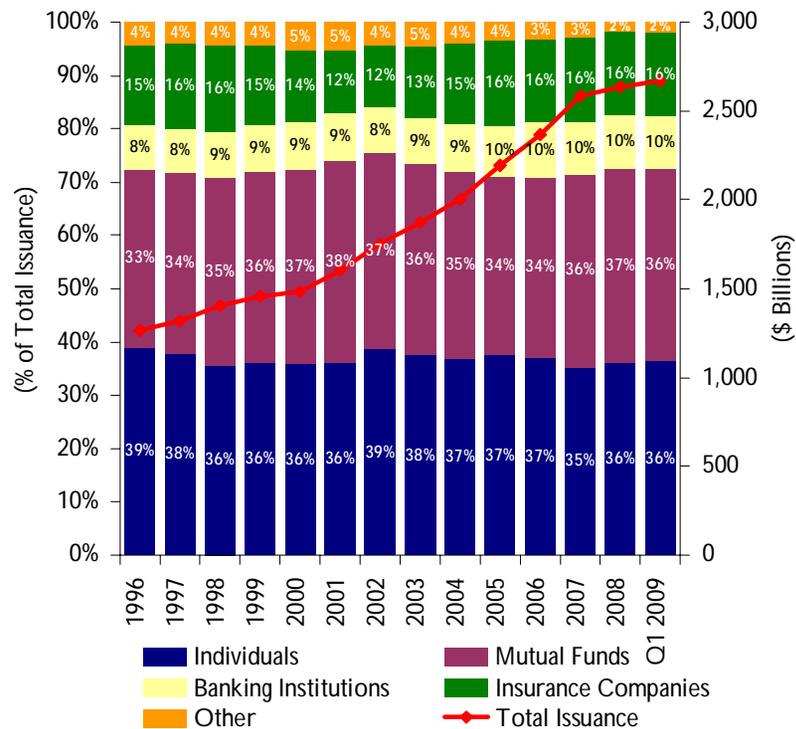
Spread between 'BAA' MMD and 'AAA' MMD (1/2/2007 – 8/19/2009)



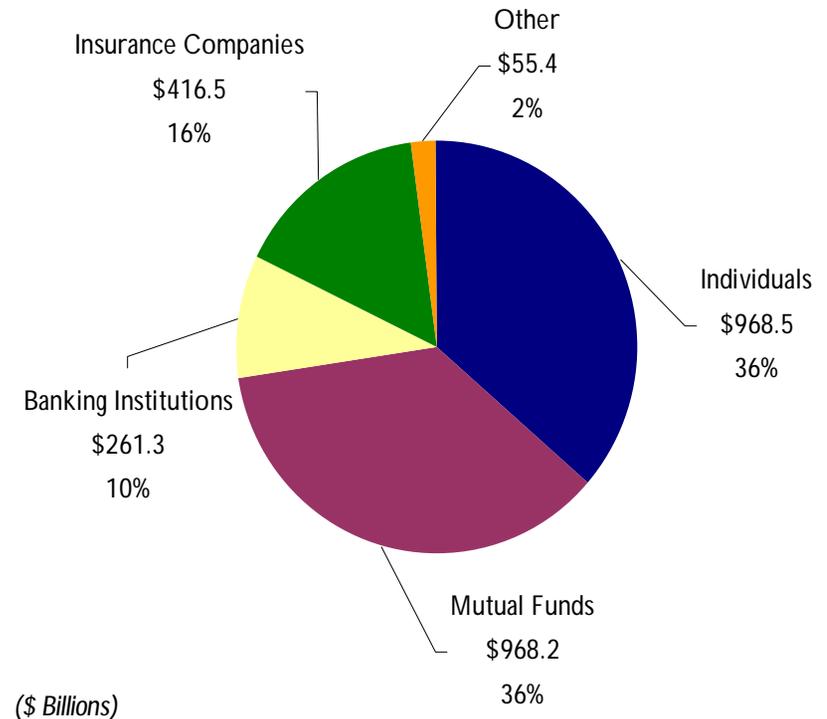
# Municipal Securities Have Had a Very Consistent Buyer Base



**Municipal Securities Holders as a % of Total Issuance (1996 – Q1 2009)**



**Municipal Securities Holders (Q1 2009 Snapshot - \$2.67 Trillion Outstanding)**



**Note:** 'Mutual Funds' includes money market funds and closed-end funds; 'Banking Institutions' means commercial banks, savings institutions and broker/dealers; 'Insurance Companies' means property/casualty and life insurance companies; and 'Other' means non-financial corporate business, nonfarm non-corporate business, state and local governments and retirement funds and GSEs.

Source: SIFMA

# Questions & Discussion

